G-010/DI-90-1144; G-010/PA-91-728 ORDER APPROVING MERGERS AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Proposed Merger of Midwest Energy, Inc. and Iowa Resources,Inc.	ISSUE DATE: January 21, 1992 DOCKET NO. G-010/DI-90-1144; G-010/PA-91-728
In the Matter of the Proposed Merger of Iowa Public Service Company and Iowa Power, Inc.	ORDER APPROVING MERGERS AND REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

On November 7, 1990, a merger took place between Midwest Energy, Inc. (Midwest Energy) and Iowa Resources, Inc. (Iowa Resources), two holding companies based in Iowa. As a result of the merger, the two companies ceased to exist and a new holding company, Midwest Resources, Inc. (Midwest Resources), came into existence.

Midwest Gas, a gas utility doing business in Minnesota, was affected by the merger because it was a division of one of Midwest Energy's subsidiaries, Iowa Public Service, Inc. (IPS). Following the merger, IPS became a subsidiary of the emerging holding company, Midwest Resources. Midwest Gas remained a division of IPS.

The merger between Midwest Energy and Iowa Resources was approved by the Securities and Exchange Commission and the Iowa Utilities Board. The Federal Trade Commission did not take any action on the merger. The Federal Energy Regulatory Commission determined that it did not have jurisdiction over the merger.

Neither Midwest Gas nor any other entity involved in the merger sought approval for the merger from the Minnesota Public Utilities Commission. Because the Minnesota Department of Public Service (the Department) felt that the merger was subject to Commission jurisdiction, the Department initiated an investigation of the merger in the current docket. The Department filed its Report and Recommendation on October 14, 1991.

On October 1, 1991, three subsidiary companies of Midwest Resources sought Commission approval to merge. The petitioners were IPS, Iowa Power, Inc. (Iowa Power) and MWR Power, Inc.

(MWR Power), a subsidiary formed for the purpose of the merger. Under the proposal, IPS and Iowa Power would merge into MWR and would cease to exist as separate entities. The petitioners' filings were updated on December 3, 1991.

On November 8, 1991, the Commission issued its ORDER APPROVING PETITION AND REQUIRING FUTURE FILINGS in Docket No. G-010/S-91-727. In that Order the Commission approved capital structure changes for IPS, the parent company of Midwest Gas.

On December 2, 1991, the Department filed comments regarding the October 1 merger petition.

On January 7, 1992, both mergers came before the Commission for consideration.

FINDINGS AND CONCLUSIONS

Commission Jurisdiction

Minn. Stat. § 216B.50 (1990) provides in part:

> No public utility shall sell, acquire, lease, or rent any plant as an operating unit in this state for a total consideration in excess of $100,000, or merge or consolidate with another public utility operating in this state, without first being authorized to do so by the commission. *** [If the commission] shall find that the proposed action is consistent with the public interest it shall give its consent and approval by order in writing.

"Public utility" is defined under Minn. Stat. § 216B.02 (1990) as:

> ...persons, corporations or other legal entities, their lessees, trustees, and receivers, now or hereafter operating, maintaining, or controlling mixed gas or electric service to or for the public or engaged in the production and retail sale thereof...

Midwest Gas is a public utility operating in this state. Midwest Gas was affected by both mergers because they created a new holding company and a new operating company for the Minnesota gas utility. Thus, under the above two statutes, the proposed mergers are subject to Commission jurisdiction. In order to approve the mergers, the Commission must find that the mergers are consistent with the public interest.

The Merger Between Midwest Energy and Iowa Resources

Method and effects of the merger

Under the terms of the November 7, 1990 merger, common shares of Iowa Resources and Midwest Energy were exchanged for shares of Midwest Resources, the surviving holding company. IPS, which had been a subsidiary of Midwest Energy, became a subsidiary of Midwest Resources.

For accounting purposes, the merger was considered a pooling of interests, in which the assets and liabilities of the merging entities are combined at their book amounts. The merger was not considered a purchase/sale transaction, and no goodwill or acquisition adjustment occurred.

Midwest Resources estimated merger-related administrative and general expense savings of approximately $8 million over the first five years following the merger. The amount of savings which would accrue to Midwest Gas would depend upon the actual amount of savings in each expense category and the method of allocation of that expense.

The Department stated that all savings projected by Midwest Resources are speculative at this time. The Department recommended that Midwest Gas be required to file an annual merger report for five years. This filing would aid the Department and Commission in monitoring the financial impact of the merger.

The merging companies estimated that the merger would bring about increased financial stability and strength, more industrial sales diversity and greater efficiency in operation, as well as general and administrative savings. A number of industry analysts, including Paine Webber and Smith Barney, stated that the merger should be a sound financial proposition.

Capital considerations

Any changes in utility investment risk, capital structure, or costs of capital may affect the utility's revenue needs and overall financial health. These factors may affect utility ratepayers through potential rate increases. Changes in the financial picture between Midwest Gas's former and present holding company or former and present parent company could affect the Minnesota utility's ratepayers. The investment risk of Midwest Resources affects Midwest Gas because investors can invest in Midwest Gas only by buying shares of Midwest Resources. For these reasons, the Commission must look carefully at the capital considerations of the merging companies, the new holding company, and IPS, which continues to provide financing for Midwest Gas.

In its investigation the Department found that the equity ratios of the merging companies are very similar and that there should not be a significant increase in the cost of capital due to the merger. The Department believed that the equity ratios of all the companies were reasonable. The Department also noted that available risk indicators were similar for the merging companies and the remaining holding company, Midwest Resources. The Department concluded that the merger should not result in significant increased risk for Midwest Gas.

The Department also examined the estimated growth rate and dividend yield of Midwest Resources, which would impact the cost of common equity. The Department concluded that Midwest Resources has a smaller investment risk than Midwest Gas, so the Minnesota utility's cost of common equity is not likely to increase as a result of the merger.

The Department believed that the merger of Midwest Energy and Iowa Resources into Midwest Resources should not have a significant impact on the overall cost of capital for Midwest Gas. The Department recommended that the merger be found consistent with the public interest.

<u>Commission action</u>

Having carefully examined the likely effects of the Midwest Energy - Iowa Resources merger upon Midwest Gas service in Minnesota, the Commission finds that the merger is consistent with the public interest. Midwest Gas ratepayers should not suffer from an increase in investment risk or cost of capital. There is a reasonable likelihood of operational savings and greater financial strength and stability for the utility.

Although the Commission finds that the merger is consistent with the public interest, the Commission will monitor the continuing financial effects of the merger upon Midwest Gas ratepayers. The Commission will require Midwest Gas to file a merger report on or before May 1, 1992, and thereafter annually for the following five years. The report must include:

1. Itemized costs and benefits to Midwest Gas from the merger of the holding companies;

2. The five-year outlook for Midwest Resource's business ventures and activities;

3. Midwest Resource's annual FERC Form 2 and its annual report to shareholders;

4. Midwest Resource's total annual A&G costs, itemized amounts allocated to Midwest Gas, and the allocation method for each cost.

The Proposed Merger of IPS, Iowa Power and MWR Power

Method and effects of the merger

The petitioners propose to merge Iowa Power and IPS into MWR Power, with MWR Power remaining as the surviving operating company. Midwest Gas would operate as a separate division of MWR Power. For accounting purposes, the transaction would be treated as a pooling of interests, with MWR Power assuming all assets and liabilities of Iowa Power and IPS. There would be no purchase/sale treatment and no acquisition or goodwill adjustments. Midwest Resources, the holding company, would continue to own all the issued and outstanding shares of common stock of the merged entity.

The petitioners state that there are no foreseeable changes in Midwest Gas service, personnel or rates due to the merger. The petitioners estimate approximately $1.2 million in merger-related costs and approximately $109 million in net savings from the merger over the next ten years. Applying an allocation factor of 6.028% for Minnesota operations, the petitioners estimate $1.8 million in savings and $76,000 in costs for Minnesota.

The petitioners also project intangible benefits from the merger. The benefits would include improved cooperation and teamwork among the utilities, and greater flexibility in dealing with industry changes.

In its report, the Department stated that the estimated quantifiable net benefits to Minnesota operations are too speculative to rely upon. The Department recommended that the Commission require annual merger reports to monitor the financial effects of the merger upon Midwest Gas.

Capital considerations

If the merger is approved, MWR Power rather than IPS would be the parent corporation for Midwest Gas. Because Midwest Gas does not issue its own debt or equity instruments, but is financed by its parent corporation, an analysis of the merger's effect on MWR Power's capital costs is necessary.

The petitioners argue that the merger will have a positive effect on costs of capital because MWR Power is a larger entity than either of the merged companies. According to the petitioners, this means that MWR Power will be able to attract capital at more favorable terms and will be able to increase its credit rating more quickly and efficiently than the merged companies.

In its report the Department stated that the post-merger entity would be similar in capital structure and capital costs to the merged companies. The Department recommended that the merger be found consistent with the public interest.

Commission action

Although the Commission is not persuaded that the increased size of the remaining operating company will necessarily result in lower cost of capital, there is no clear evidence that the merger will result in higher capital costs. Any projected changes in costs of equity, investment risk and capital structure seem reasonable and appropriate in light of possible merger-related benefits. The Commission therefore finds that the proposed merger among IPS, Iowa Power and MWR Power is consistent with the public interest.

In order to monitor the financial effects of the merger, the Commission will require Midwest Gas to file a merger report on or before May 1, 1992, and thereafter annually for the next five years. The report must include:

1. Itemized costs and benefits to Midwest Gas from the merger of the operating companies, total and per customer;

2. The five-year outlook for MWR Power's business activities;

3. Year-end actual capital structures for Midwest Resources and MWR Power; and

4. Any other information needed to show the full effects of the merger.

In addition, the Commission will require Midwest Gas to file a completely updated procedures manual for allocating costs. This filing will assist the Commission in its ongoing assessment of the financial effects of the merger upon Midwest Gas.

ORDER

1. The merger between Midwest Energy, Inc. and Iowa Resources, Inc. is approved.

2. The merger of Iowa Public Service Company and Iowa Power, Inc. into MWR Power, Inc. and the capital structure of the surviving utility, MWR Power, Inc., are approved.

3. On or before May 1, 1992, and on an annual basis thereafter, Midwest Gas shall file a merger report including the following information:

    a. Itemized costs and benefits to Midwest Gas from the merger of the holding companies, Midwest Energy, Inc. and Iowa Resources, Inc. into Midwest Resources, Inc.;

b. The five-year outlook for Midwest Resources' business ventures and activities;

c. Midwest Resources' annual FERC Form 2 and its annual report to shareholders;

d. Midwest Resources' total annual A&G costs, an itemization of all costs allocated to Midwest Gas, and the allocation methodology for each cost;

e. Itemized costs and benefits to Midwest Gas, on a total and per customer basis, from the merger of the operating companies, Iowa Public Service, Inc. and Iowa Power, Inc., into MWR Power, Inc.;

f. The five-year outlook for MWR Power's business activities;

g. Year-end capital structures for Midwest Resources and MWR Power; and

h. Any other information needed to show the full effects of the merger.

4. On or before 60 days from the date of the Order, Midwest Gas shall file a completely updated procedures manual for allocating costs.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)